No. 126, Original

# In the Supreme Court of the United States

STATE OF KANSAS, PLAINTIFF

*v.*

STATE OF NEBRASKA AND STATE OF COLORADO

*ON EXCEPTIONS TO THE REPORT OF THE SPECIAL MASTER*

## BRIEF OF THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF OVERRULING THE PARTIES' EXCEPTIONS TO THE REPORT OF THE SPECIAL MASTER

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## QUESTIONS PRESENTED

The United States will address the following questions:

1. Whether a monetary damages remedy for Nebraska's breach of the Republican River Compact (Compact), Act of May 26, 1943, ch. 104, 57 Stat. 86, should include partial disgorgement of the amount by which Nebraska's gain from the breach exceeds Kansas's loss. (Nebraska Exception No. 1; Colorado Exception).

2. Whether the Court should provide Kansas with specific injunctive relief in the form of an order requiring Nebraska to comply with the Compact and the parties' Final Settlement Stipulation (FSS). (Kansas Exception No. 2.A).

3. Whether the Court should enter an order reforming the accounting procedures adopted in the FSS to correct a mistake identified by Nebraska. (Kansas Exception No. 1).

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### INTEREST OF THE UNITED STATES

This case presents questions of (i) the appropriate remedy for Nebraska's breach of the Republican River Compact, Act of May 26, 1943, ch. 104, 57 Stat. 86, and (ii) whether the Court should reform the accounting procedures in the parties' Final Stipulation Settlement (FSS) to correct a mistake identified by Nebraska. The United States has a substantial interest in the proper implementation of interstate compacts apportioning water in an interstate stream. At the Court's invitation, the United States filed a brief at an earlier stage of these proceedings recommending that the Court grant Kansas leave to file its petition for enforcement of the Court's Decree of May 19, 2003, which approved the FSS.

## STATEMENT

The State of Kansas initiated these proceedings by filing a petition to enforce against the State of Nebraska this Court's Decree of May 19, 2003, which approved the Final Settlement Stipulation (FSS) entered into by Kansas, Nebraska, and Colorado. 538 U.S. 720; see Report of the Special Master (Report) App. E1-E56. The FSS was the culmination of proceedings initiated by Kansas in 1998 to enforce its rights under the Republican River Compact (Compact), which was approved by Congress in the Act of May 26, 1943, ch. 104, 57 Stat. 86.

This Court granted Kansas leave to file its petition for enforcement of the Decree and appointed the Honorable William J. Kayatta, Jr., to serve as the Special Master. 131 S. Ct. 1847 (2011). Special Master Kayatta has submitted a report that recommends, in relevant part, that the Court: (1) declare that Nebraska breached the Compact by consuming a total of 70,869 acre-feet of water in excess of its Compact allocation in 2005 and 2006 (Report 2, 89); (2) enter judgment against Nebraska and in favor of Kansas in the amount of $5.5 million, $1.8 million of which represent a partial disgorgement of Nebraska's gain from breaching the Compact (*id.* at 179, 187); (3) deny Kansas's request for specific injunctive relief (*id.* at 187); and (4) order the accounting procedures used by the States reformed to correct a mistake identified by Nebraska (*id.* at 2, 187). Kansas, Nebraska, and Colorado have filed exceptions to the Master's report. The United States supports the Master's report and therefore files this brief as amicus curiae in support of overruling the parties' exceptions.

**A. The Republican River Basin**

The Republican River Basin is a 24,900-square-mile watershed, approximately 430 miles in length, that encompasses parts of northeastern Colorado (7700 square miles), southwestern Nebraska (9700 square miles), and northern Kansas (7500 square miles). The Republican River originates in Colorado at the junction of the Arikaree and North Fork Republican Rivers, then flows northeast through the northwest corner of Kansas. The river crosses into Nebraska near Haigler, Nebraska, flows east across southwestern Nebraska, then crosses back into Kansas south of Hardy, Nebraska. From there, it flows southeasterly to Junction City, Kansas, where it joins the Smoky Hill River to form the Kansas River. The Basin contains fertile farmland and typically receives from 18 to 30 inches of precipitation per year. See Bureau of Reclamation, U.S. Dep't of the Interior, *Resource Management Assessment: Republican River Basin* 3-6, 43, 44-48 (July 1996) (*Resource Management Assessment*) (a copy of this report was lodged with the Clerk of the Court in the 1998 proceeding in this case).

During the 1930s, after the Basin had experienced an extended drought interrupted in 1935 by a dangerous and deadly flood, the federal and state governments examined whether the Republican River's spring flows could be impounded in reservoirs for flood control and released in the late summer and fall for irrigation. See H.R. Doc. No. 842, 76th Cong., 3d Sess. (1940) (U.S. Army Corps of Engineers (Corps) preliminary examination of Republican River); see also H.R. Doc. No. 195, 73d Cong., 2d Sess. 158-186 (1934). Based on the Corps' recommendations, Congress authorized appropriations to construct the Har-

lan County Reservoir for flood control purposes in Nebraska. See Act of Aug. 18, 1941, ch. 377, 55 Stat. 646.

During that time, the Bureau of Reclamation, which has primary responsibility for irrigation projects, also examined the Republican River Basin. See Bureau of Reclamation, U.S. Dep't of the Interior, *Project Investigations Report No. 41*, at 1-2 (1940). The Bureau concluded that development of federal irrigation projects in the Basin would be feasible, *id.* at A-D (Synopsis), but that no projects should be constructed until the three States had agreed to an interstate allocation of the Basin's water resources. *Id.* at 1.

**B. The Republican River Compact**

With the permission of Congress, see Act of Aug. 4, 1942, ch. 545, 56 Stat. 736, the States conducted compact negotiations, which were completed on December 31, 1942. The state legislatures ratified the proposed compact. Colo. Rev. Stat. Ann. §§ 37-67-101 *et seq.* (West 2010); Kan. Stat. Ann. § 82a-518 (1997); 2A Neb. Rev. Stat. Appx. § 1-106 (2008). Congress then enacted legislation approving the Compact. Act of May 26, 1943, ch. 104, 57 Stat. 86.

The Compact comprises 11 Articles that allocate the water supply of the Basin among Colorado, Kansas, and Nebraska. The Compact quantifies the Basin's "Virgin Water Supply," which is defined as "the water supply within the Basin undepleted by the activities of man." Art. II, 57 Stat. 87. The Compact prescribes the specific quantities of the virgin water supply, in acre-feet per year, that each State is allocated for "Beneficial Consumptive Use," which is defined as "that use by which the water supply of the Basin is

consumed through the activities of man, * * * includ[ing] water consumed by evaporation from any reservoir, canal, ditch, or irrigated area." *Ibid.*

Article IV sets out the allocation to each State for each of the Basin's drainage areas. 57 Stat. 88-89. In doing so, Article IV allocates the entire estimated virgin water supply, giving Colorado an aggregate of 54,100 acre-feet per year, Kansas an aggregate of 190,300 acre-feet per year, and Nebraska an aggregate of 234,500 acre-feet per year. *Ibid.* In addition, Article IV recognizes that Kansas is entitled to "the entire water supply originating in the Basin downstream from the lowest crossing of the river at the Nebraska-Kansas state line." *Id.* at 88.

In accordance with Article IX of the Compact, 57 Stat. 90, the States formed the Republican River Compact Administration (RRCA). The RRCA is comprised of the chief water official of each State. It "may, by unanimous action, adopt rules and regulations consistent with the provisions of th[e] compact." *Ibid.* The RRCA computes the Basin's annual virgin water supply, which allows the States to determine, retrospectively, whether each State has stayed within its allocation. See RRCA, *First Annual Report for the Year 1960* (1961).

Between the late 1940s and the 1960s, seven federal dams and reservoirs were constructed in the Basin above the Nebraska-Kansas border. Six are Bureau projects, and Harlan County Reservoir is a Corps project. The Bureau's projects, operated in conjunction with the Corps' Harlan County facilities, have an active storage capacity of approximately 450,898 acre-feet of water and provide water to six irrigation districts serving 137,595 acres of farmland in the Basin.

See U.S. Bureau of Reclamation, U.S. Dep't of Interior, *Niobrara, Lower Platte, and Kansas River Basins Annual Operating Plans* Tables 1, 3 (2012).

### C. Previous Litigation And The Final Settlement Stipulation

Beginning in the 1980s and continuing into the 1990s, Kansas complained to the RRCA that Nebraska was violating the Compact by allowing increasing groundwater development that was reducing the inflow of water into Harlan County Reservoir. RRCA, *25th Annual Report* 7 (1985). Nebraska took the position that groundwater pumping was not subject to the Compact.

In 1999, this Court granted Kansas's motion for leave to file a bill of complaint against Nebraska and invited Nebraska to test its theory in a motion to dismiss. 525 U.S. 1101; 527 U.S. 1020. The Court referred the ensuing motion to a Special Master. 528 U.S. 1001 (1999). The Master recommended that Nebraska's motion be denied, concluding that the Compact encompassed groundwater withdrawals that impacted the virgin water supply. See First Report of the Special Master (Subject: Nebraska's Motion to Dismiss), in No. 126, Orig. (Jan. 28, 2000). The Court denied Nebraska's Motion to Dismiss. 530 U.S. 1272 (2000).

The States then began negotiations to resolve the remaining issues in the suit. Following more than a year of additional negotiations, the States entered into the FSS. See Report App. E1-E56.

The FSS incorporates procedures to calculate the virgin water supply and each State's allocation, and it establishes each State's requirements for Compact compliance. Report App. E25-E47. Under the FSS,

Nebraska's compliance requirements include: (1) a five-year running-average test limiting Nebraska's beneficial consumptive use to no more than its statewide allocation, FSS Art. IV.D, Report App. E34; and (2) during water-short periods (Water-Short Year Administration), an additional two-year or three-year running-average test limiting Nebraska's beneficial consumptive use above Guide Rock, Nebraska to no more than Nebraska's allocation above Guide Rock plus its share of any unused portion of Colorado's allocation. FSS Art. V.B, Report App. E37-E44. Water-Short Year Administration is in effect in those years in which the projected or actual irrigation supply is less than 119,000 acre-feet of storage available for use from Harlan County Reservoir. FSS Art. V.B.1, Report App. E37-E38.

The FSS includes dispute-resolution provisions that require the States to submit their disputes to the RRCA for resolution. FSS Art. VII.A, Report App. E47-E50. If the RRCA cannot reach consensus, the parties may submit the dispute to non-binding arbitration under Article VII.B. FSS Art. VII.A.7, Report App. E49-E50. This Court approved the FSS in a decree dated May 19, 2003. 538 U.S. 720. In that same decree the Court ordered the dismissal with prejudice of all claims, counterclaims, and cross-claims that had been brought or could have been brought prior to December 15, 2002, effective upon filing by the Special Master of a final report certifying adoption of a RRCA Groundwater Model by the parties. *Ibid.*

Through six months of additional technical work and negotiations, the States reached agreement on the RRCA Groundwater Model, which is a model for cal-

culating the impacts of groundwater pumping and depletions in each State. See Final Report of the Special Master with Certificate of Adoption of RRCA Groundwater Model, in No. 126, Orig. (Sept. 17, 2003); 540 U.S. 964 (2003) (noting filing of Final Report). The Groundwater Model is administered according to the RRCA Accounting Procedures, which are part of the FSS.

**D. The Current Controversy**

1. By 2007, several disputes had arisen among the States concerning compliance with the FSS. Nebraska overused its Compact allocation in 2003, and thus knew that it would need to underuse in the following years to satisfy the first five-year running average test. Report 108. Nebraska again exceeded its Compact allocation in 2004 and 2005, and it faced an added challenge in 2006 because that year was designated as a water-short accounting year and thus triggered the application of a two-year water-short accounting period for 2005-2006. *Id.* at 108-109; see FSS Art. V.B, Report App. E37-E44. Kansas asserted that Nebraska overused its allocation during the two-year accounting period by a total of approximately 79,000 acre-feet, in violation of the Compact and the FSS. Kan. Pet. for Enforcement 9-10. Nebraska, in response, identified errors in the Accounting Procedures that prevented an accurate accounting of each State's allocation by as much as 10,000 acre-feet per year, and asserted that those errors should be corrected before the parties could determine the extent of Nebraska's violation. Neb. Br. in Resp. 8-9, 24.

As required by Article VII.A of the FSS, the States presented these issues to the RRCA, but the RRCA could not reach a consensus on either issue. The

States then submitted their claims to non-binding arbitration pursuant to Article VII.A.7 of the FSS. Neb. Br. in Resp. App. 79-108 (arbitrator's final decision on damages); Arbitrator's Final Decision on Nebraska Crediting Dispute, https://www.agriculture.ks.gov/docs/default-source/iwi---republican-river-compact/2010_10_07_pagel_decision_nebraska_crediting.pdf?sfvrsn=2. The States rejected the arbitrators' recommendations.

2. Having exhausted the FSS's alternative dispute resolution requirements, Kansas filed a motion in this Court for leave to file a petition for enforcement of the Court's Decree of May 19, 2003, which had approved the FSS. Kansas sought an order adjudging Nebraska in contempt of the Decree and retrospective monetary damages in the form of disgorgement of Nebraska's profits. Kan. Pet. for Enforcement 11-12. Kansas also sought prospective relief, including: an order enjoining Nebraska from future violations and imposing preset sanctions for noncompliance, an order reducing groundwater pumping in Nebraska to a level sufficient to ensure Nebraska's future compliance, and appointment of a river master. *Id.* at 12.

The Court granted Kansas leave to file its petition and referred the case to Special Master Kayatta. 131 S. Ct. 1847 (2011). Before the Special Master, Nebraska asserted a counterclaim seeking an order that would modify the Accounting Procedures to eliminate an error that allows water imported into the Basin as a result of man-made diversions from the Platte River Basin to be incorrectly treated as part of the Republican River Basin's virgin water supply, and thus improperly counted toward Nebraska's "Computed Ben-

eficial Consumptive Use" under the Groundwater Model. Report 11, 15.

3. The Master conducted hearings and received briefs and arguments on the parties' claims. Report 1, 10-14. On November 13, 2013, the Master issued a report containing his recommendations.

a. The Master concluded that Nebraska had breached the Compact by consuming a total of 70,869 acre-feet of water in excess of its Compact allocation in 2005 and 2006, the first water-short accounting period. Report 2, 89; see Neb. Excp. Br. 7 (accepting that conclusion). Turning to the remedy for Nebraska's breach, the Master noted that "all three states agree that the remedy should be in dollars." Report 129. He recommended that the Court enter a judgment against Nebraska and in favor of Kansas in the amount of $5.5 million. *Id.* at 187.

The Master reviewed the evidence presented by the parties and concluded that $3.7 million was "a fair estimate" of Kansas's loss. Report 138; see *id.* at 136-172. He further concluded that the evidence showed that an acre-foot of water was substantially more valuable on-farm in Nebraska than it was in Kansas, and that "Nebraska's gain was therefore very much larger than Kansas' loss, likely by more than several multiples." *Id.* at 178. In light of that conclusion, the Master considered whether any part of Nebraska's gain should be disgorged as part of Kansas's monetary remedy.

The Master explained that, following adoption of the FSS, "Nebraska failed to act either promptly or effectively in enacting intrastate rules that would limit consumption of the Basin's virgin water supply to the amounts allowed under the Compact." Report 107.

The Master stated that the first Integrated Management Plans (IMPs) developed by the Nebraska Department of Natural Resources and Nebraska's Natural Resource Districts (NRDs) were "clearly not sufficient, either in timing or substance," in that they did not go into effect until 2005 and required only a 5% reduction in groundwater pumping. *Id.* at 107-108. The Master further explained that "[m]uch of Nebraska's struggle with compliance" arose from the state legislature's decision to maximize local control over groundwater resources without providing any mechanism to hold local irrigators responsible for overuse. *Id.* at 110. The Master acknowledged that Nebraska had some "bad luck" due to dry years between 2002 and 2006, but he explained that "prior experience rendered it foreseeable that there would likely be both dry and wet periods, and Nebraska took steps adequate, at most, only for the latter." *Id.* at 107-110.

The Master noted that Nebraska had taken steps by 2006 to reduce the extent of its noncompliance by reducing groundwater pumping, purchasing surface water, using voluntary programs for retiring acreage from irrigation, and reducing allocations for groundwater irrigators, although "[t]he net result of these efforts * * * fell woefully short." Report 109, 111. Because of those efforts, the Master concluded that Nebraska had not deliberately breached the Compact. *Id.* at 111, 130-131. But the Master concluded that "Nebraska knowingly exposed Kansas to a substantial risk that Nebraska's compliance measures would not ensure compliance if the weather did not cooperate." *Id.* at 130; *id.* at 112 ("Nebraska hoped to comply, but knowingly failed.").

The Master acknowledged that disgorgement is typically awarded only in cases of "deliberate" breach, as an alternative to a traditional damages award reflecting the injured party's reasonably foreseeable loss. Report 130. But the Master concluded that partial disgorgement is nevertheless warranted here. He explained that the States' rights to water of an interstate stream "are in some respects similar to rights in real property," and "[a]ctions involving the taking of real property * * * routinely apply disgorgement as the measure of damages." *Id.* at 131-132 (citing Restatement (Third) of Restitution and Unjust Enrichment § 40 (2011)). The Master further explained that "the Compact is a law of the United States," and "[a]ctions arising out of a breach of statutory law often employ measures of damages aimed at divesting the wrongdoer of any gains derived from the statutory violation." *Id.* at 132.

Against this background, the Master reasoned that the Court is not required to "make an either-or selection between the measures of loss and gain" and that the Court should "look at loss and gain as end points on a spectrum of damages, and then * * * calibrate the selection of a fair point on that spectrum." Report 135. He ultimately concluded that the Court should award an additional $1.8 million to Kansas, which "represents a disgorgement of a small portion of the amount by which Nebraska's gain exceeds Kansas's loss" and "moves substantially towards turning the actual recovery by Kansas, net of reasonable transaction costs, into an amount that approximates a full recovery for the harm suffered." *Id.* at 179; Errata to Report (Errata) (Nov. 19, 2013).

The Master concluded that disgorgement beyond $1.8 million was unnecessary based on Nebraska's substantial efforts after 2006 to mitigate its noncompliance and to ensure future compliance. Report 179. The Master explained that in 2007, Nebraska "turn[ed] over a new leaf" by enacting legislation requiring the adoption of a mechanism for mandatory annual forecasts to help the NRDs stay within their compliance allocations, and that Nebraska has now developed third-generation IMPs that (i) provide for a reduction of surface water use during forecasted dry years; (ii) increase the groundwater pumping reduction from 5% to 25%; and (iii) affirmatively require each NRD to reduce consumption by the amount of its proportionate responsibility for maintaining Nebraska's compliance with the Compact, reinforced by a mandatory shut-down of groundwater pumping in a designated Rapid Response Region if adequate action is not taken. *Id.* at 113-114, 180. The Master determined that "the case is compelling that the current IMPs will be effective to maintain compliance even in extraordinarily dry years," *id.* at 118, but that "[s]hould Nebraska not manage to employ its new IMPs with the efficacy claimed," the Court "should make clear" that further disgorgement would be ordered. *Id.* at 180.

b. The Master concluded that the specific injunctive relief requested by Kansas is not warranted. Report 180-186. The Master explained that Kansas had not shown that an injunction is necessary to prevent future violations because "the record falls short of establishing that the current IMPs, if followed conscientiously, are not capable of ensuring Nebraska's compliance going forward." *Id.* at 182. The Mas-

ter also pointed out that "[u]nder the reasoning of [his] Report, Nebraska's incentive to extend its recent record of strong compliance should be increased by its knowledge that, in the event of a relapse after this date, Nebraska will have a difficult time parrying a request for disgorgement even in the absence of a deliberate breach." *Id.* at 183.

The Master separately rejected Kansas's request that Nebraska be held in contempt of the Court's Decree of May 19, 2003, which approved the FSS. Report 99-103. The Master explained that there was "no language in the actual Decree ordering any party to comply with either the Compact or the FSS," *id.* at 99, and that "[i]f Nebraska is to be held liable in this action, it must be held liable for violating the Compact as interpreted and implemented by the FSS, not for violating any court order." *Id.* at 101.

c. The Master further concluded that the Accounting Procedures should be reformed to correct the error identified by Nebraska. Report 19-71. In its counterclaim, Nebraska contended that in dry conditions, the Accounting Procedures, which were adopted by the parties to administer the Groundwater Model used to calculate the impacts of groundwater pumping in each State, "mistakenly treat the consumption of imported water in some circumstances as if it were the consumption of virgin water supply of the Basin." *Id.* at 22. Nebraska contended that this error caused the Groundwater Model to erroneously increase the calculation of Nebraska's consumption of the virgin water supply in a way that was "contrary to the parties' shared intent in agreeing to the Accounting Procedures, and to the Compact." *Id.* at 22, 32.

The Master agreed. Report 32-37. The Master explained that the Compact was intended only to divide the virgin water supply "originating in" the Basin, Art. III, 57 Stat. 87, and that the FSS explicitly states that consumption of imported water "shall not count as Computed Beneficial Consumptive Use or Virgin Water Supply" for purposes of the Accounting Procedures, FSS Art. IV.F, Report App. E35. See Report 23-24. But, the Master noted, the Accounting Procedures nevertheless count imported water as part of the Basin's virgin water supply in some circumstances because of an interaction between two factors.

First, under the Compact and the FSS, groundwater pumping counts as consumption only to the extent that it depletes stream flow. Report 34. If the stream were to run dry, however, further groundwater pumping would not cause any stream flow depletion. *Ibid.* In other words, "stream flow * * * fall[s] as groundwater pumping increases until it hits zero, at which point it falls no more even as groundwater pumping continues." *Ibid.* Second, imported water can create stream flow in a dry riverbed. *Ibid.* The Accounting Procedures, the Master explained, do not eliminate that effect before running the simulation in those conditions, which can lead the Groundwater Model to include imported water in its computation of each State's beneficial consumptive use of the virgin water supply. *Id.* at 35. The Master found that Nebraska had shown this was the case "quite convincingly." *Ibid.* Colorado agreed that the Accounting Procedures should be changed to correct this problem, but Kansas did not. *Id.* at 22. Because the procedures cannot be changed without the unanimous consent of

the parties, see Compact Art. IX, 57 Stat. 90, Nebraska requested relief from this Court. Report 22-23.

The Master concluded that the Accounting Procedures should be reformed to correct the problem Nebraska had identified. Report 37-54. The Master explained that equitable reformation of a contract is appropriate where the writing "fails to express the agreement because of a mistake of both parties as to the contents or effect of the writing." *Id.* at 43 (citing Restatement (Second) of Contracts § 155 (1981)). The Master found that Nebraska had clearly established that the parties did not intend for the Accounting Procedures to treat imported water as part of the virgin water supply, and that the current Accounting Procedures "nevertheless have exactly this unintended effect under some circumstances." *Ibid.* The Master determined that a simple solution proposed by Nebraska (included as Appendix F to the Report) solves the problem by assuming, before the Groundwater Model is run to calculate each State's groundwater usage, that Nebraska does not import water into the Basin. Report 55-56. The Master concluded that the reformed procedures should be applied from 2007 forward. *Id.* at 69-71.

## SUMMARY OF ARGUMENT

I. This Court has broad discretion to provide a "fair and equitable solution" for the breach of an interstate compact governing the apportionment of an interstate river. *Texas* v. *New Mexico*, 482 U.S. 124, 134 (1987). A damages award that includes partial disgorgement of the breaching party's gain falls within that broad discretion. If damages for breach of an interstate compact were strictly limited to the injured State's reasonably foreseeable loss, that would give

rise to special concerns about "efficient breach" in the context of interstate compacts: In circumstances where water can be put to greater beneficial use in an upstream State, that State would have no incentive to prevent a breach of the compact, because it would benefit from using the water upstream and paying the downstream State the lower value of its loss. Especially in cases in which the remedy of specific performance of the obligation to deliver water is not feasible, disgorgement can provide an appropriate additional measure to discourage such a breach.

Moreover, when a State breaches an ongoing obligation under an interstate compact, disgorgement can help stabilize the relationship under the compact and ensure that the injured State's entitlement to water is adequately protected. Such a remedy can also be important to ensure that federal irrigation projects have adequate surface flow to operate. Furthermore, disgorgement is a recognized remedy where one party interferes with the property rights of another, and where a party obtains a benefit by breaching a trust relationship. Those scenarios are analogous to Nebraska's use of water in excess of its allocation under the Compact and the FSS.

The Master's recommendation to award partial disgorgement based on what he found to be Nebraska's knowing exposure of Kansas to the risk of a breach of the Compact rests on a thorough evaluation of the relevant considerations of fairness and justice. At the same time, the Master's conclusion that full disgorgement is unwarranted in light of evidence showing that Nebraska has positioned itself to ensure compliance going forward is also well supported.

II. The Master's conclusion that the specific injunctive relief requested by Kansas is not warranted should be upheld. Kansas has requested an order of this Court that would require Nebraska to comply with the Compact and the FSS. In light of Nebraska's recent efforts to ensure future compliance, the Master was justified in concluding that such injunctive relief is not warranted.

III. It is within this Court's equitable authority to reform the Accounting Procedures to correct the mistake that Nebraska has identified. The Master found (and Kansas does not dispute) that in dry conditions, the Accounting Procedures sometimes treat Nebraska's consumption of imported water within the Basin as if it were consumption of the virgin water supply. Yet the parties explicitly agreed in the FSS that consumption of imported water would *not* count toward the calculation of a State's consumption of the virgin water supply. FSS Art. IV.F, Report App. E35.

The Master found that the parties were not aware that the Accounting Procedures had this effect, and that the error was not accepted in exchange for other benefits conferred on Nebraska. Based on those findings, reformation is appropriate to bring the Accounting Procedures into line with a basic premise underlying the Compact and the parties' agreement in the FSS.

## ARGUMENT

### I. IT IS WITHIN THE COURT'S DISCRETION TO AWARD PARTIAL DISGORGEMENT IN THIS ORIGINAL ACTION

Nebraska (Excp. Br. 10-16) and Colorado (Excp. Br. 4-11) have filed exceptions to the Master's recommendation that Nebraska should be ordered to pay

$1.8 million—in addition to Kansas's actual damages of $3.7 million—as "a disgorgement of a small portion of the amount by which Nebraska's gain exceeds Kansas's loss." Report 179; Errata. An award of partial disgorgement is within the Court's broad discretion.

### A. The Availability Of A Disgorgement Remedy In Appropriate Circumstances Is Important To Ensure Compliance With An Interstate Compact Apportioning The Water Of An Interstate Stream

The Court's jurisdiction in interstate compact disputes is "basically equitable in nature." *Ohio* v. *Kentucky*, 410 U.S. 641, 648 (1973). In developing a remedy for breach of a compact, the Court has broad discretion to provide a "fair and equitable solution that is consistent with the Compact terms." *Texas* v. *New Mexico*, 482 U.S. 124, 134 (1987). The Court's discretion is exercised "according to settled principles of equity, but not arbitrarily and capriciously, and always with reference to the facts of the particular case." *Id.* at 131 (citation omitted).

1. The Court, in *Texas* v. *New Mexico*, stated that money can be an appropriate remedy for breach of an interstate compact for the delivery of water. 482 U.S. at 130. In a previous case, damages for such a breach have been awarded based on the injured party's reasonably foreseeable loss. See Second Report of Arthur Littleworth, Special Master 80, in *Kansas* v. *Colorado*, No. 105, Orig. (Sept. 9, 1997) (Littleworth Report); 533 U.S. 1, 6, 20 (2001) (noting the Special Master's recommendation that damages be measured by Kansas's loss rather than Colorado's profits, overruling unrelated objections, and remanding for calculation of damages); see also 556 U.S. 98, 103 (2009) (final judgment). The Court has left open, however,

the possibility that disgorgement of the breaching party's gain may be awarded as a remedy for breach in an appropriate case.

In *Texas* v. *New Mexico*, the Court responded to the concern that money damages may be an inadequate remedy for breach of an interstate compact apportioning water because the remedy would permit an upstream State "to ignore its obligation to deliver water as long as it is willing to suffer the financial penalty." 482 U.S. at 132. The Court concluded that the concern was insubstantial "in light of the authority to award remedying shortfalls to be made up in kind, with whatever additional sanction might be thought necessary for deliberate failure to perform." *Ibid.*; see also Littleworth Report 80-82 (explaining that although Kansas's damages should be limited to the State's reasonably foreseeable loss based on the facts of that case, there is "no doubt about the power of equity to provide complete relief, perhaps even looking to upstream gain under appropriate circumstances"). After the Court clarified that money damages were an appropriate remedy, the parties settled the dispute for $14 million. 494 U.S. 111, 111 (1990).

The incentive for an "efficient breach," which would exist in cases where water can be put to greater beneficial use in an upstream State, as the Master concluded was the case here (Report 178), is a cause for special concern in the context of interstate compacts apportioning water. If the remedy for anything less than a deliberate breach is strictly limited to the downstream State's reasonably foreseeable loss, then the upstream State may lack a sufficient incentive to work diligently to prevent a breach, "as long as it is

willing to suffer the financial penalty." *Texas* v. *New Mexico*, 482 U.S. at 132.

Although the continued availability of specific performance through an order to make up for a shortfall in kind may alleviate this concern to some extent, a remedy in the form of water is not always feasible. See *Texas* v. *New Mexico*, 482 U.S. at 131-132. In this case, for example, the Master explained that such a remedy would raise difficult questions about the timing and location of any requirement to deliver water. Report 129. In cases where specific performance is not appropriate, disgorgement can provide a suitable "additional sanction" designed to discourage continued breach. *Texas* v. *New Mexico*, 482 U.S. at 132; see *Porter* v. *Warner Holding Co.*, 328 U.S. 395, 400 (1946) ("Future compliance may be more readily assured if one is compelled to restore one's illegal gains.").

2. It is also relevant that a case such as this involves an ongoing agreement between States to limit their use of water to an agreed-upon amount and thus for the upstream State to deliver to the downstream State its allocated share. In such cases, disgorgement of the breaching party's gain can serve to "reinforce the stability of the contract." See Restatement (Third) of Restitution and Unjust Enrichment § 39, cmt. b. Moreover, as the Master recognized (Report 131), States agree to apportion the water of an interstate steam based on the premise that each State has a sovereign right to use a portion of the water. See, *e.g.*, *Nebraska* v. *Wyoming*, 325 U.S. 589, 617 (1945). If damages were strictly limited to the injured State's loss, thereby allowing for an efficient breach on an ongoing basis, that remedy may "afford inadequate

protection to the promisee's contractual entitlement" to water. See Restatement (Third) of Restitution and Unjust Enrichment § 39. Those circumstances can thus justify a disgorgement remedy when it is necessary to ensure compliance with an interstate compact.

Concerns about an upstream State's failing to abide by an obligation under an interstate compact, which is an Act of Congress, are reinforced where water from the interstate stream supports irrigation projects that are authorized by other Acts of Congress and depend on surface water flows to function. Decline in irrigation water supply can cause water users to default on repayment and water-supply contracts with the United States, thus potentially reducing revenues needed to repay project costs associated with those contracts. Further, if the Bureau cannot exercise its state-law water rights to provide a water supply to irrigation districts as required by its repayment contracts, those water rights could be injured. In addition to these risks, a decline in water supply can harm fish, wildlife, and recreation in federal reservoirs, thereby reducing the ability of the Bureau and the Corps to furnish the full range of benefits envisioned by Congress.

Those concerns are present in the Republican River Basin. Surface water flows into the Basin have declined significantly since the mid-1960s, and inflows to federal reservoirs in the Basin have declined steadily. *Resource Management Assessment*, 13-15. The decline in surface flow is strongly correlated with the increase of groundwater-well development in Nebraska. HDR Engineering, Inc., *Hydrologic Trends and Correlations in the Republican River Basin in Nebraska*, 1-14 (June 2006) (prepared for Neb. Dep't of Natural Resources).

3. Disgorgement is also a recognized remedy where one party interferes with the property interests of another. Restatement (Third) of Restitution and Unjust Enrichment § 40 cmt. b, § 51(4). When interference with property is at stake and restitution takes the form of a money judgment, the measure of recovery "depends on the blameworthiness of the defendant's conduct," *id.* § 40 cmt. b, and conscious wrongdoers (*i.e.*, those who act "despite a known risk that the conduct in question violates the rights of the claimant," *id.* § 51(3)) may be "stripped of gains from unauthorized interference with another's property," *id.* § 40 cmt. b. As the Master explained (Report 131-132), in practical terms, "one might fairly say that Nebraska took Kansas' water."

Furthermore, disgorgement is a recognized remedy against a party who obtains a benefit by breaching a fiduciary relationship. See Restatement (Third) of Restitution and Unjust Enrichment § 43. Where a fiduciary gains an advantage from the breach, "[a]ny such advantage must be given up to the beneficiary." *Id.* cmt. b; see *Harris Trust and Savs. Bank* v. *Salomon Smith Barney, Inc.*, 530 U.S. 238, 250 (2000) (where trustee in breach of fiduciary duty transfers trust property to a third person, the beneficiary may maintain an action against the transferee for disgorgement of proceeds (if the property was disposed of) so long as the transferee knew or should have known that the trustee was in breach of his duties). Under an interstate compact, an upstream State is in some respects in a position analogous to that of a fiduciary that is charged by the compact with ensuring that an adequate amount of water in its possession flows to a downstream State.

Based on these considerations, the Court in an appropriate case may order partial disgorgement of an upstream State's gain "according to settled principles of equity." *Texas* v. *New Mexico*, 482 U.S. at 131 (citation omitted).

### B. An Award Of Partial Disgorgement Is Justified In This Case

The Master concluded in this case that disgorgement of "a small portion of the amount by which Nebraska's gain exceeds Kansas's loss" is justified as a remedy to Kansas for Nebraska's breach. Report 179; Errata. The Master explained in detail how Nebraska, after adoption of the FSS, "failed to act either promptly or effectively in enacting intrastate rules that would limit consumption of the Basin's virgin water supply to the amounts allowed under the Compact." Report 107. The Master recounted how the initial IMPs developed by the Nebraska Department of Natural Resources and the NRDs were "clearly not sufficient, either in timing or substance," to ensure Nebraska's compliance, and that the Nebraska legislature ceded too much control over groundwater resources to local irrigators without sufficient oversight. *Id.* at 107-110.

The Master concluded that the result of those deficiencies was to "knowingly expose[] Kansas to a substantial risk that Nebraska's compliance measures would not ensure compliance if the weather did not cooperate." Report 130. In the Master's judgment, a modest disgorgement award would provide an appropriate signal to Nebraska that future violations would not be acceptable. *Id.* at 180, 183 (explaining that the reasoning of the Report should increase "Nebraska's

incentive to extend its recent record of strong compliance").

The nature of the Court's original jurisdiction and its broad discretion in formulating fair and equitable remedies in such cases, see *Texas* v. *New Mexico*, 482 U.S. at 130-131, permits the Court to fashion an appropriate remedy, including an award of partial disgorgement. The Master's recommendation to award partial disgorgement is based on a thorough evaluation of the relevant considerations of fairness and justice.[1]

2. a. Nebraska and Colorado contend that disgorgement is not an appropriate remedy absent "nefarious intent" to violate the Compact (Neb. Excp. Br. 8) or a "callous and deliberately opportunistic" breach (Colo. Excp. Br. 7). But disgorgement can be appropriate even where the breaching party's actions fall short of bad faith. Disgorgement is typically available against a "conscious wrongdoer," which includes a defendant who has been enriched by misconduct and who acts "(a) with knowledge of the underlying wrong to the claimant, or (b) despite a known risk that the conduct in question violates the rights of the claimant." Restatement (Third) of Restitution and Unjust

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[1] The United States does not urge that $1.8 million is precisely the right amount of disgorgement. But the Master was justified in awarding *some* amount of disgorgement in light of his careful balancing of the equities at stake. The Master's analysis of the equities justifying a modest disgorgement should satisfy the Court that the approval of $1.8 million would not reflect an exercise of equitable discretion that is "arbitrar[y] [or] capricious[]," *Texas* v. *New Mexico*, 482 U.S. at 131 (citation omitted), especially in light of the cost and burden of additional proceedings before the Master to further consider and explain that amount. Indeed, neither party proposes a remand of the matter to the Master for that purpose.

Enrichment § 51(3). The Master's conclusions about Nebraska's compliance efforts prior to 2007 (Report 111-112, 136) fall within that ambit of discretion.[2]

The provision of the Restatement addressing "opportunistic breach" provides that disgorgement is warranted where there has been a "deliberate" breach that results in profit to the defaulting promisor and where a traditional damages remedy is inadequate to protect the injured party's contractual entitlement. Restatement (Third) of Restitution and Unjust En-

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[2] Nebraska has filed an exception to the Master's determination that Nebraska "knowingly failed" to comply with the Compact. See Neb. Excp. Br. 16-19 (Nebraska Exception No. 2). Nebraska contends (*id.* at 17) that the years leading up to the violation of the FSS in 2006 (the end of the first two-year water-short accounting period) presented conditions of unprecedented drought. The Master appropriately observed, however, that the Compact specifically contemplates that there would be wet and dry years, and that Nebraska had made inadequate plans to remain within its Compact allocation when the amount of available water was low. Report 107-109. Nebraska further contends (Excp. Br. 18-19) that because the Accounting Procedures call for retrospective accounting of beneficial consumptive use, it is "literally impossible for [a State] to know its Compact compliance status until the following year." The Master thoroughly explained, however, that Nebraska exceeded its Compact allocation in every year beginning in 2003; that it did not take adequate steps to balance such overuse in succeeding years as would be necessary to satisfy the five-year running average test; and that at the very least Nebraska "knew it had not taken the steps it needed to take in order to underuse * * * [in] a water-short year," which triggers a more immediate two-year compliance test. Report 108-109. Accordingly, the Master's conclusion (*id.* at 130) that Nebraska "knowingly exposed Kansas to a substantial risk that Nebraska's compliance measures would not ensure compliance if the weather did not cooperate" is well supported.

richment § 39. But the commentary makes clear that the restriction to cases of "deliberate" breach is meant to "exclud[e] cases in which breach results from the defendant's inadvertence, negligence, or unsuccessful attempt at performance," and is "consistent with the general principle that disgorgement remedies in restitution are principally addressed to instances of conscious wrongdoing." *Id.* cmt. f. Moreover, the Court's discretion to provide "a fair and equitable solution that is consistent with the Compact terms" is broad enough to include a modest amount of disgorgement based on the knowing creation of a significant risk of a violation of the Compact. *Texas* v. *New Mexico*, 482 U.S. at 134.

b. Kansas contends (Excp. Br. 53-54) that the full amount of Nebraska's gain should be disgorged to eliminate the possibility of profit from wrongdoing. The Master explained in detail Nebraska's attempts, although they fell "woefully short," to come into compliance by 2006, Report 109-111, and he was satisfied that Nebraska's legislative overhaul beginning in 2007 presented a "compelling [case] that the current IMPs will be effective to maintain compliance even in extraordinarily dry years," *id.* at 113-114, 118, 180. Based on those efforts, the Master appropriately concluded that an order requiring disgorgement of the full amount of Nebraska's gain was not required. See *Texas* v. *New Mexico*, 482 U.S. at 131 (Court's discretion to award an equitable remedy must be exercised with "with reference to the facts of the particular case"); *Kansas* v. *Colorado*, 533 U.S. at 14 (concluding that the Master had "acted properly in carefully analyzing the facts of the case and in awarding only as

much prejudgment interest as was required by a balancing of the equities").

Kansas suggests (Excp. Br. 56-59) that if full disgorgement is not awarded, then treble damages ($11.1 million, representing three times Kansas's actual loss of $3.7 million) would be appropriate. But damages are not typically trebled absent specific statutory authority for that type of award, see, *e.g.*, 18 U.S.C. 1964(c) (RICO); 15 U.S.C. 15 (Clayton Act), and the Master appropriately concluded that, based on Nebraska's demonstrated efforts to come into compliance and to work diligently toward compliance in the future, disgorgement of only a relatively small portion of Nebraska's gain is warranted at this time.

c. Colorado contends (Excp. Br. 9-11) that any disgorgement would result in a "windfall" to Kansas. That argument should be rejected. It is a basic feature of the remedy of disgorgement that "a claimant potentially recovers more than a provable loss so that the defendant may be stripped of a wrongful gain." Restatement (Third) of Restitution and Unjust Enrichment § 3, cmt. a. Disgorgement is designed to ensure that the *breaching* party does not receive a windfall by "profit[ing] by his own wrong." *Id.* § 3. The award of a modest disgorgement award in this case would serve to discourage continued breach by Nebraska and falls within this Court's broad discretion to provide a fair and equitable remedy for Nebraska's breach of the Compact.

## II. THE INJUNCTIVE RELIEF REQUESTED BY KANSAS IS NOT WARRANTED

Kansas has filed an exception (Kan. Excp. Br. 36-44) to the Master's conclusion that, in light of the evidence showing that Nebraska had positioned itself

to ensure compliance with the Compact going forward, the injunctive relief requested by Kansas is not warranted. See Report 180-186. Kansas contends (Excp. Br. 37) that the Court should order Nebraska to comply with the Compact and the FSS. In Kansas's view (*id.* at 36-38, 43-44), such an order is justified so that Kansas may seek contempt sanctions against Nebraska for any future violations of the Compact (because Nebraska would be violating the Court's order), instead of requesting leave to file a new complaint that the Court might, in its discretion, decline to accept.[3]

The Master's conclusion that injunctive relief would not "add anything meaningful to the mix" was justified. Report 183. Although Kansas expresses skepticism about Nebraska's future compliance, Nebraska demonstrated to the Master's satisfaction that its efforts to come into compliance with its Compact obligations are serious. *Id.* at 113-114, 179-180. The partial disgorgement award recommended by the Master will serve to reinforce that assurance. *Id.* at 183.

Nebraska is required to comply with the Compact and the FSS without an order of this Court. Kansas can obtain damages from Nebraska for any future violations either through a settlement, or through further proceedings that this Court deems appropriate for an exercise of its original jurisdiction. See

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[3] That is the approach Kansas took in this case. Instead of filing a motion for leave to file a complaint against Nebraska, Kansas filed a motion for leave to file a petition to enforce the Court's Decree of May 19, 2003, which approved the FSS. See Kan. Pet. for Enforcement 3-13. The Maser rejected that request, concluding that the Decree itself imposed no obligations on the parties. See Report 99-103.

*Mississippi* v. *Louisiana*, 506 U.S. 73, 76-77 (1992) (stating that the Court's jurisdiction is "obligatory only in appropriate cases" and requires an examination of "the nature of the interest of the complaining State" and the "seriousness and dignity of the claim") (citation omitted); *Texas* v. *New Mexico*, 462 U.S. 554, 575 (1983) (encouraging States to resolve disputes through settlement). The Master properly concluded, based on the evidence before him, that an additional order requiring Nebraska to comply with the Compact and the FSS, which Kansas views as a mechanism for more direct access to this Court in the event of a future breach (Excp. Br. 36-37), is not warranted at this time.

## III. IT IS WITHIN THIS COURT'S DISCRETION TO REFORM THE RRCA ACCOUNTING PROCEDURES

Kansas takes exception (Br. 17-34) to the Master's recommendation that the Court should reform the Accounting Procedures to correct the error identified by Nebraska. Nebraska demonstrated that the Accounting Procedures sometimes treat the consumption of imported water within the Basin as if it were consumption of the Basin's virgin water supply "by including imported water when running the model simulations" that are used to calculate each State's consumption of groundwater. Report 36-37.

The testimony of a Colorado witness verified that under the current Accounting Procedures, Nebraska is incorrectly charged for the consumption of imported water in some circumstances (Report 33), and Colorado agrees that the procedure should be changed. Kansas does not dispute the existence of the feature Nebraska has identified, but it does not agree to a change in the procedure.

The Master's suggested route to correct this error through reformation of the Accounting Procedures is reasonable. Reformation is an available remedy where a "writing * * * fails to express the agreement because of a mistake of both parties as to the contents or effects of the writing." Restatement (Second) of Contracts § 155; see *Philippine Sugar Estates Dev. Co.* v. *Government of Philippine Islands*, 247 U.S. 385, 389 (1918). The Master correctly concluded that the parties expressly intended that consumption of imported water within the Basin would not count toward a state's "Computed Beneficial Consumptive Use" of the virgin water supply. Report 24, 43 (citing FSS Art. IV.F, Report App. E35). The Accounting Procedures nevertheless do so in the circumstances Nebraska describes, which is inconsistent with the parties' agreement. *Id.* at 43.

The change to the Accounting Procedures also corresponds to the terms of the Compact itself, which was intended only to divide the virgin water supply "originating in" the Basin. Art. III, 57 Stat. 87. By counting the consumption of water that is imported from the Platte River Basin against Nebraska's beneficial consumptive use of the virgin water supply, the Accounting Procedures expanded the scope of the Compact to include water from another basin in the parties' division of water. Counting the consumption of imported water against Nebraska's beneficial consumptive use also reduces the amount of the virgin water supply that Nebraska may consume, which is contrary to the allocation made in the Compact. In those respects, the FSS is "especially amenable to reformation" because the change brings the parties rights and obligations in line with the Compact's divi-

sion of water. Report 42; cf. *Vermont* v. *New York*, 417 U.S. 270 (1974) (suggesting that a settlement agreement would not be binding if it conflicts with an interstate compact).

Kansas contends (Excp. Br. 20-23) that the feature about which Nebraska complains was not a mistake, and that the parties all agreed that the model they created was only intended to "approximate actual conditions" and was "was sufficient for its intended purposes." Kansas further contends (*id.* at 24-29) that the States were generally aware of the problem and nevertheless agreed to the Accounting Procedures after extensive negotiation. The Master rejected those arguments and explained that, based on the evidence presented during the proceedings, the parties were not aware that the Accounting Procedures contained this error (Report 26-27), Nebraska was not accepting the error in exchange for some other tradeoff (*id.* at 28), and Kansas did not negotiate with a "bottom line" in mind that would have caused it to reject Nebraska's proposed solution (*id.* at 28-32). Based on these findings, the Master reasonably concluded that reforming the Accounting Procedures to prevent Nebraska's consumption of imported water from being counted toward its allocated share of the virgin water supply "would be effectuating, not changing, the FSS." *Id.* at 51.

As the Master explained (Report 38), the Court could not reform the terms of the Compact itself, because the Compact is a law of the United States that required congressional approval to become effective. See *Texas* v. *New Mexico*, 482 U.S. at 128. But the FSS is not an interstate compact, and it did not require congressional approval because it expressly did

not "change the States' respective rights and obligations under the Compact." FSS Art. I.D; see Report 41.

Reforming the FSS as the Master suggested in Appendix F of the Report would not undermine the willingness of States to enter into settlement agreements when disputes arise. As the Master explained, reformation is not available "simply to reflect better judgments or accommodate new facts." Report 54. The remedy requires "a clear showing that a document need be rewritten to correct an error of expression—in words or in math—that materially conflicts with the actual agreement." Report 54. The Master thoroughly explained why that remedy was justified here.

In the initial years after the FSS was approved, Nebraska did not have in place procedures that were adequate to ensure the State would stay within its agreed-upon allocation of water. If the Master's recommendation is accepted, Kansas will be compensated for the water it was entitled to receive during that period. It appears that Nebraska now has a plan in place to stay within its allocation going forward. As the States move on from this settling-in period following approval of the FSS, the Accounting Procedures should be reformed to accurately reflect the agreement, expressed in both the FSS and the Compact, that consumption of imported water will not count toward a party's allocation of the Basin's virgin water supply.

## CONCLUSION

The exceptions of Nebraska and Colorado to the Special Master's recommendation to award Kansas partial disgorgement of Nebraska's gain, and the exceptions of Kansas to (i) the Special Master's recommendation against an award of specific injunctive relief and (ii) the Special Master's recommendation that the Court should reform the RRCA Accounting Procedures, should be overruled.

Respectfully submitted.

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